

## Section 14

### ***Abusive Tax Schemes***

#### **A. TRUSTS**

The IRS cautions taxpayers about the dangers of placing their assets in abusive or illegal trusts, which taxpayers ultimately control. Trust arrangements of concern to the IRS are those which ignore the true ownership of assets or the substance of the transactions. Promoters of these arrangements claim that they allow the owner to retain full benefit of business or personal assets while greatly reducing or eliminating taxes. Contrary to these claims, there are no additional benefits to be derived from placing assets in a trust. The substance of a transaction, not its form, controls for tax purposes.

The IRS is not discouraging taxpayers from placing their assets in trust for legitimate reasons, rather than tax avoidance/evasion. However, if the enticing tax deductions sound too good to be true, get a second opinion before investing.

#### **Recognizing a problem trust**

Look for these common warning signs that may reveal an unscrupulous trust promotion:

- A promise to reduce or eliminate income and self-employment tax.
- Deductions for personal expenses paid by the trust.
- Depreciation deductions on an owner's personal residence and furnishings.
- High fees for trust packages, to be offset by promised tax benefits.
- Use of back-dated documents.
- Unjustified replacement of trustee.
- Lack of an independent trustee.
- Use of post office boxes for trust addresses.
- Use of terms such as *pure trust*, *constitutional trust*, *sovereign trust*, or *unincorporated business organization*.

#### **For more information:**

- For information on how to amend a previously filed tax return, call the IRS at 1-800-829-1040 or refer to the [1040X Instructions](#).
- For specific questions regarding tax schemes, or if you wish to report possible schemes, call 1-800-829-0433 or send an e-mail to [irs.tax.shelter.hotline@irs.gov](mailto:irs.tax.shelter.hotline@irs.gov).

- Learn more about [abusive tax schemes](#) by visiting the IRS Criminal Investigations Web site.
- Visit the IRS Web site for frequently asked questions about [trusts](#).

**References:**

- [Notice 97-24](#), Certain Trust Arrangements
- [Publication 2193](#), Too Good to be True – Should Your Financial Portfolio Include Trusts.

**B. HOME-BASED BUSINESS TAX AVOIDANCE**

Most taxpayers with home-based businesses accurately report their income and expenses. However, in recent years, the IRS has uncovered a number of home-based business tax avoidance schemes. The promoters of these schemes claim that individual taxpayers can deduct most, or all, of their personal expenses as business expenses by setting up a bogus home-based business. However, the tax code firmly establishes that a clear business purpose and profit motive must exist in order to generate and claim allowable business expenses.

**Non-deductible personal living expenses cannot be transformed into deductible business expenses.**

- This is true regardless of how convincing the information in marketing materials may seem.
- Consult applicable [Internal Revenue Code](#) (IRC) sections including, but not limited to: 127, 162, 183, 195, 262, and 274.

**A few examples of items that are generally not deductible as business expenses:**

- Paying children a salary (e.g., for answering telephones, washing cars, etc.).
- Deducting personal travel, meals, and entertainment under the guise that everyone you encounter is a potential client.
- Deducting all or most of the cost and operation of a personal residence. For example, placing a calendar, desk, file cabinet, telephone, or some other business-related item in each room does not increase the amount that can be deducted.
- Deducting education expenses from salaries paid to children wrongfully claimed as employees.
- Deducting excessive car and truck expenses when a vehicle was used for both personal and business use.
- Deducting personal furniture, home entertainment equipment, children's toys, etc.

**Be aware that:**

- Depreciation recapture rules apply when business assets, including a personal residence, are later sold.
- A "bona fide" business must truly exist prior to claiming business-related expenses.
- Any investment scheme or promotion that claims to allow a person to deduct what would normally be personal expenses as business expenses, should be considered highly suspect.

**For more information:**

- For information on how to amend a previously filed tax return, call the IRS at 1-800-829-1040 or refer to the [1040X Instructions](#).
- For specific questions regarding tax schemes, or if you wish to report possible schemes, call 1-866-775-7474 or send an e-mail to [irs.tax.shelter.hotline@irs.gov](mailto:irs.tax.shelter.hotline@irs.gov).
- [Frequently asked questions](#) about [home-based business tax avoidance](#).

**References:**

- The following IRS Forms and Publications:
  - [Publication 587](#), Business Use of Your Home
  - [Publication 463](#), Travel, Entertainment, Gift, and Car Expenses
  - [Publication 334](#), Tax Guide for Small Business
  - [Publication 17](#), Your Federal Income Tax for Individuals
  - [Publication 4035](#), Too Good to be True – Home-Based Business Tax Avoidance Schemes

**Home-Based Business Tax Avoidance – Frequently Asked Questions and Answers****Q.) Is it wrong to deduct costs associated with businesses, including home-based businesses?**

**A.)** The tax laws allow individuals to claim legitimate business expenses. However, there are promoters who are suggesting that taxpayers can deduct most, or all, of their personal expenses as business expenses by setting up a home-based business. Any tax scheme that claims a person can deduct what would normally be personal expenses should be considered highly suspect. A business must truly exist prior to claiming business-related expenses.

**Q.) What should I do if I have deducted business expenses on a return that are actually non-deductible personal expenses?**

**A.)** If you believe you have incorrectly claimed expenses, you should file an amended return. If the amended return results in additional tax owed, you may also be subject to interest and penalties. However, amending your return may reduce the amount of penalties and interest that you eventually owe.

**Q.) What happens if I do not amend my return?**

**A.)** If your return is audited, the possible penalties, interest, and legal costs associated with an abusive tax promotion can be significant. Criminal penalties may also apply. This is in addition to the tax due and fees you paid for the promotion. You can contact the Internal Revenue Service at 1-800-829-1040, if you have any questions.

## **C. SLAVERY REPARATIONS TAX SCHEME**

Thousands of African Americans have been misled by people offering to file for tax credits or refunds related to reparations for slavery. There is no such provision in the tax law. Some unscrupulous promoters have encouraged clients to pay them to prepare a claim for this refund. But the claims are a waste of money. Promoters of reparations tax schemes have been convicted and imprisoned. Taxpayers could face up to a \$500 penalty for filing such claims if they do not back away from the claim.

**For more information:**

- For information on how to amend a previously filed tax return, call the IRS at 1-800-829-1040 or refer to the [1040X Instructions](#).
- For specific questions regarding tax schemes or if you wish to report possible schemes call 1-800-829-0433 or send an e-mail to [irs.tax.shelter.hotline@irs.gov](mailto:irs.tax.shelter.hotline@irs.gov).
- Visit the [IRS Criminal Investigation](#) Web site.

**References:**

- [News Release IR-2002-08](#), Slavery Reparation Scams, IRS Urges Taxpayers Not to File False Claims, January 24, 2002.
- [Fact Sheet FS-2002-08](#), Reparation Scams Carry a Price, January 24, 2002.

### **Slavery Reparations – Frequently Asked Questions and Answers**

**Q.) What are Slavery Reparations (also known as Black Investment Tax), and are African Americans entitled to them?**

**A.)** Slavery reparations – also known as black tax, black investment tax, and black inheritance tax, among other terms – is the idea that African Americans should receive repayment for historical slavery. Currently, there is no law that allows the payment of reparations. Therefore, neither the IRS, nor any other federal agency, can pay any form of reparations, black tax, black investment tax, refunds, or credits to African Americans for slavery.

Right after the Civil War, Congress voted to provide former slaves with 40 acres and a mule as repayment for their years in slavery, but this was vetoed by then-President Andrew Johnson and never became a law.

**Q.) Is it true that a credit is due to African Americans, but the IRS does not want it publicized – so do not call the IRS for information, just apply?**

**A.)** It is not true that a credit is due to African Americans – this is a hoax. There is no provision in tax law that allows for any form of reparations payable to African Americans for slavery. Some unscrupulous people who charge taxpayers a fee to prepare and/or file claims for reparations simply do not want their potential victims to learn the truth. Taxpayers who have questions about tax laws should contact a trusted tax professional or call 1-800-829-1040 toll free to receive assistance from IRS representatives.

**Q.) Will individuals who file for reparation credits be penalized or prosecuted by the IRS?**

**A.)** Under a new policy, which began on April 15, 2002, the IRS will first send a warning letter to the individual. The letter will state that the claim has no basis in law and will offer an opportunity to correct the return or withdraw the claim with no penalty imposed. Those who do not agree to do so will face a \$500 frivolous filing penalty, allowable under IRC Section 6702. Previously, an individual could submit more than one slavery reparations claim before the penalty was imposed. However, some promoters are encouraging people to file repeat claims, so the IRS had to develop a new policy.

**Q.) If I have given a tax preparer my power of attorney and he files a reparation claim on my behalf without my knowledge, could I be penalized by the IRS?**

**A.)** A power of attorney is a signed document that authorizes the recipient to act on your behalf. Therefore, you are responsible for whatever actions the recipient takes on your behalf. This means you could be held liable for a frivolous return filed on your behalf – even without your prior knowledge – by someone to whom you have given your power-of-attorney and you could be fined \$500. It is usually not a good idea to give anyone your power-of-attorney or access to your financial data unless you really trust them.

**Q.) In many communities, individuals are charging fees to prepare tax returns for reparations. What is IRS's advice to "would be followers"?**

**A.)** Do not be misled by tax scam operators. If a tax benefit sounds too good to be true, it usually is. Check it out with your local IRS office first.

**Q.) Scam operators are distributing flyers and hosting fee-based seminars in many areas to entice African Americans to apply for this "would be credit." What, if anything, is being done to put these people out of business? Will they be prosecuted?**

**A.)** The IRS has zero tolerance for illegal refund schemes and will prosecute promoters of such schemes. Promoters of reparations returns have been convicted, fined, and imprisoned. For example, one person was sentenced to almost 5 years in prison for filing false claims. The IRS continues to investigate promoters for possible criminal prosecution or civil action.

**Q.) If someone has filed a claim, what should they do now?**

**A.)** Contact IRS representatives at 1-800-829-1040 for assistance. If taxpayers have information about a tax scam involving reparations, they should call the IRS at 1-800-829-0433.

**Q.) Copies of IRS refund checks are being circulated in some communities. If the credit is not legitimate, why are checks being issued?**

**A.)** The IRS has rejected thousands of reparation claims since 1994. In some cases, the IRS may have mistakenly processed reparation claims. Since millions of refunds are issued yearly, a small number of refunds are issued in error. The IRS will contact any taxpayer who received an erroneous refund to arrange repayment.

## **D. OTHER COMMON TAX SCAMS**

Taxpayers need to be alert so that they do not fall victim to tax scams. Common tax schemes to avoid:

- **NO TAXES BEING WITHHELD FROM YOUR WAGES**

Illegal schemes are being promoted that instruct employers not to withhold federal income tax or employment taxes from wages paid to their employees. These schemes are based on an incorrect interpretation of tax law and have been refuted in court. If you have concerns about your employer and employment taxes, you can get help by calling the IRS at 1-800-829-1040.

- **"I DON'T PAY TAXES—WHY SHOULD YOU?"**

Con artists may talk about how they do not file or pay taxes and then charge people a fee to share their "secret." The real secret that these people do not reveal is that many of them actually do file and pay taxes, they just will not publicly admit it. Again, the IRS reminds people that failure to file or pay taxes is subject to civil and/or criminal tax penalties.

- **PAY THE TAX, THEN GET THE PRIZE**

The caller says you have won a prize and all you have to do to get it is pay the income tax due. Do not believe it. If you really won a prize, you may need to make an estimated tax payment to cover the taxes that will be due at the end of the year. But the payment goes to the IRS, not the caller. Whether you have won cash, a car, or a trip, the prize giver generally sends you and the IRS a Form 1099 showing the total prize value that should be reported on your tax return.

- **UNTAX YOURSELF FOR \$49.95**

This one is as old as snake oil, but people continue to be taken in. And now it is on the Internet. The ads may say that paying taxes is "voluntary," but it is absolutely wrong. The U.S. courts have continuously rejected this and other similar arguments. Unfortunately, hundreds of people across the country have bought "untax packages" before finding out that following the advice contained in them can result in civil and/or criminal tax penalties being assessed. Numerous sellers of these bogus packages have been convicted on criminal tax charges.

- **SOCIAL SECURITY TAX SCHEME**

Taxpayers should not fall victim to a scam offering them refunds of the Social Security taxes they have paid during their lifetimes. The scam works by the victim paying a "paperwork" fee of \$100, plus a percentage of any refund received, to file a refund claim with the IRS. This hoax fleeces the victims for the up-front fee. The law does not allow such a refund of Social Security taxes paid.

- **"I CAN GET YOU A BIG REFUND . . . FOR A FEE!"**

Refund scheme operators may approach you wanting to "borrow" your Social Security Number or give you a phony W-2 so it appears that you qualify for a big refund. They may promise to split the refund with you, but the IRS catches most of these false refund claims before they go out. And when one does go out, the participant usually ends up paying back the refund along with stiff penalties and interest. Two lessons to remember: 1) Anyone who promises you a bigger refund without knowing your tax situation could be misleading you, and 2) Never sign a tax return without looking it over to make sure it is honest and correct.

- **SHARE/BORROW EARNED INCOME TAX CREDIT (EITC) DEPENDENTS**

Unscrupulous tax preparers "share" one client's qualifying children with another client in order to allow both clients to claim the EITC. For example, if one client has four children they only need to list two for EITC purposes to get the maximum credit. The preparer will list two children on the first client's return and list the other two on another client's tax return. The preparer and the client "selling" the dependents split a fee. The IRS prosecutes the preparers of such fraudulent claims, and participating taxpayers could be subject to civil penalties.

- **IRS "AGENT" COMES TO YOUR HOUSE TO COLLECT**

First, do not let anyone into your home unless they identify themselves to your satisfaction. IRS special agents, field auditors, and collection officers carry picture IDs and will normally try to contact you before they visit. If you think the person on your doorstep is an impostor, lock your door and call the local police. To report IRS impostors, call the Treasury Inspector General's Hotline at 1-800-366-4484.



- **CLAIM DISABLED ACCESS CREDIT FOR PAY PHONES**

Con artists sell expensive coin-operated pay telephones to individuals, contending they can claim a \$5,000 Disabled Access Credit on their tax return because the telephones have volume controls. In reality, the Disabled Access Credit is limited to bona fide businesses that are coming into compliance with the Americans with Disabilities Act.

**For more information:**

- For information on how to amend a previously filed tax return call the IRS at 1-800-829-1040 or refer to the [1040X Instructions](#).
- For specific questions regarding tax schemes, or if you wish to report possible schemes, call 1-800-829-0433 or send an e-mail to [irs.tax.shelter.hotline@irs.gov](mailto:irs.tax.shelter.hotline@irs.gov).
- For more information, visit the [IRS Criminal Investigation](#) Web site, or the [Tax Scams/Fraud Alerts](#) section of the IRS Web site.

**References:**

- [Publication 2105](#), Why Do I Have to Pay Taxes
- [Publication 3995](#), Too Good To Be True – Recognizing Illegal Tax Schemes

**Non-Government Web sites:**

- [www.quatloos.com](http://www.quatloos.com)
- [www.taxprophet.com](http://www.taxprophet.com)

**Tax Scams – Frequently Asked Questions and Answers**

**Q.) The information presented by the promoter sounded legitimate. Now I have concerns regarding this promotion. Who do I contact to report information on the promotion and promoter?**

**A.)** Contact the Internal Revenue Service at 1-800-829-0433 or e-mail our Tax Shelter Hotline at [irs.tax.shelter.hotline@irs.gov](mailto:irs.tax.shelter.hotline@irs.gov).

**Q.) Can I get more information on the Internet?**

**A.)**Yes. Additional information is available at the following sites:

[IRS Criminal Investigation](#) Web site – This site provides information on various tax schemes and explains how to report suspected tax fraud activity.

[Tax Scams/Fraud Alerts](#) – This section provides information on various tax scams and provides other information and alerts.

[Abusive Tax Shelters](#) – This section describes various abusive tax shelters and provides links to other sites.

Forms and Publications that provide additional material on this subject:

- [Publication 2105](#), Why Do I Have to Pay Taxes
- [Publication 2193](#), Too Good to be True – Should Your Financial Portfolio Include Trusts
- [Publication 4035](#), Too Good to be True – Home-Based Business Tax Avoidance Schemes